CHRIS-CRAFT CORP. V. PIPER AIRCRAFT CORP.: LIABILITY IN THE CONTEXT OF A TENDER OFFER

BY CHARLES F. DUGAN II AND MARY ELLEN FAIRFIELD*

I. SUMMARY OF THE BATTLE FOR CONTROL

The heated contest for control of Piper Aircraft Corporation which occurred in 1969 spawned a number of lawsuits which culminated in the decision of the United States Court of Appeals for the Second Circuit in March, 1973.[1] That decision represents a landmark in the interpretation and application of the federal securities laws to contests for corporate control. The decision is the first to grant standing to a defeated contestant for corporate control in a tender offer to sue for damages under § 14(e)[2] of the Securities Act of 1934.[3] By implication, the decision also extends standing to sue for damages to a successful contestant who has been damaged by the securities laws violations of its opponent. By providing standing under § 14(e) to contestants for corporate control, *Chris-Craft* undoubtedly will retard the expansion of standing under rule 10b-5,[4] which has gradually been broadened through exceptions to the *Birnbaum*[5] doctrine.

Chris-Craft has also served to set standards of corporate behavior in a tender offer contest not only for the target corporation but for the contestants and underwriters as well. It has defined the specificity with which management must evaluate competing tender offers and has incorporated the fiduciary duty owed by management of the target corporation to its shareholders into § 14(e) standards. The area in which *Chris-Craft* may have its greatest impact is in defining the standards of conduct of underwriters in a tender offer. Although the court purportedly ap-

---

* Members of the Ohio Bar.

1 Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973). [Hereinafter referred to as Chris-Craft].

2 15 U.S.C. § 78n(e) (1971). Section 14(e) adopts much of the language of rule 10b-5 in the context of a tender offer:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation....

3 Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78jj (1971).

4 17 C.F.R. § 240.10b-5 (1973).

5 Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952).

plied the substantive law developed under rule 10b-5, in reality it expanded the duties and liabilities of the underwriter far beyond those applicable under rule 10-b5.

Chris-Craft has also established an impliedly conclusive presumption of market effect arising from technical violation of rule 10b-6.[6] Under the Second Circuit's formulation in *Chris-Craft*, plaintiff need only show a violation of the technical language of rule 10b-6; thereafter, all that remains is the question of damages. A violator of the rule cannot escape liability by attempting to show that the transaction involved was one which the rule was designed not to reach—that is, a transaction which did not involve an effect on the market.

Lastly, *Chris-Craft* may have dealt a stunning blow to the availability, at least in the Second Circuit, of the permanent injunction as a weapon in the arsenal of the Securities and Exchange Commission against habitual offenders under the securities laws. While the decision did not clarify the standards for injunctive relief in the Second Circuit, it indicated that even in those cases where the record is replete with securities law violations, the court of appeals will not reverse the findings of a district judge who has denied an injunction. Moreover, the opinion can be read as holding that a showing of an offender's specific intent to violate the securities laws must be made before the Second Circuit will grant permanent injunctive relief.

The complexity of the facts in the case reflect the intensity of the battle and will be summarized here. The target company, Piper Aircraft Corporation, was one of the three leading manufacturers of general aircraft. Incorporated in 1937, Piper in 1969 was still strongly influenced by the Piper family, who held three of the eight positions on the board of directors and owned approximately 501,000 shares out of a total of 1,644,890 outstanding shares.[7]

Chris-Craft Industries, Inc., the unsuccessful contender, although principally engaged in the manufacture of recreational products, in 1968 embarked on an aggressive program of expansion through acquisition. In December of 1968 Chris-Craft focused its attention on Piper and began purchasing Piper shares on the New York Stock Exchange. By January 22, 1969, Chris-Craft had accumulated more than 200,000 Piper shares at a cost of $11,500,000, about thirteen percent of the outstanding stock of Piper. During this period, Chris-Craft had made no formal statement of interest in Piper, and had given no indication that its objec-

---

[6] 17 C.F.R. § 240.10b-6 (1973).

[7] Brief for Appellee Piper Aircraft Corp. at 18.

tive was control of Piper.[8] On January 23, 1969, Chris-Craft announced a cash tender offer for 300,000 Piper shares at sixty-five dollars per share and reserved the right to accept additional shares.[9]

As a result of the cash tender offer, approximately 304,000 Piper shares were tendered to Chris-Craft out of the approximately 900,000 which were then in the hands of the public. Chris-Craft continued to purchase Piper shares on the market for cash. By February 27, it had acquired approximately thirty-three percent of Piper's outstanding stock. On that date, Chris-Craft filed a registration statement with the Securities and Exchange Commission covering an exchange offer for up to 300,000 shares of Piper stock. The registration statement did not become effective until May 15, 1969 and, after being extended six times, was withdrawn when Chris-Craft had obtained less than 40,000 shares through the exchange offer.[10]

Upon receiving formal notification from Chris-Craft of the commencement of the tender offer and of Chris Craft's tentative plans to acquire a majority shareholder interest in Piper, William T. Piper, President of Piper, immediately countered with a series of defensive maneuvers. These included several letters to Piper shareholders in which the Chris-Craft offer was described as "inadequate" and the possibility of more beneficial mergers was raised.

At the same time, Piper management and representatives of First Boston Corporation, Piper's investment bankers, met with representatives of Grumman Aircraft Corporation in an effort to effectuate a merger between Grumman and Piper. Piper management on January 29 issued a press release, which it also mailed to its shareholders, stating that Grumman Aircraft Engineering Corporation had agreed to purchase 300,000 shares of Piper at sixty-five dollars per share and was studying the feasibility of a combination of the two companies. The release stated that Piper could expect to benefit materially from its association with Grumman.[11]

Certain elements of the agreement between Grumman and Piper were not disclosed in the press release. For example, the agreement included a "put" clause which allowed Grumman to tender the 300,000 Piper shares back to Piper at sixty-five dollars per share, plus interest at the nominal annual rate of 3½ percent for a period of seven months, while it

[8] 480 F.2d at 350.

[9] *Id.* at 351.

[10] *Id.*

[11] *Id.* The market reacted negatively to the announcement. The closing price of Piper stock on the New York Exchange, which had been 64-1/4 on January 28, the day before the press release, declined to 61-5/8 the day of the announcement and to 59-5/8 on February 3, 1969, the day on which Chris-Craft's cash tender offer terminated. Brief for Appellee Piper Aircraft Corp. at 17.

considered the desirability of a merger. Piper was obligated to segregate the Grumman funds in trust so as to protect Grumman's "put." The Grumman option agreement was subsequently cancelled.[12]

Meanwhile, Piper continued its defensive efforts. After consultation with First Boston, Piper attempted unsuccessfully to acquire two unrelated companies outside the aircraft industry.[13] In its search for a compatible merger, Piper had begun negotiating as early as January 1969 with Bangor Punta Corporation, but it was not until May 1969 that an arrangement satisfactory to both corporations' managements was achieved. Under the contract, the Piper family agreed to exchange its block of 501,000 shares for a package of specified Bangor Punta common stock and debentures. Bangor Punta also agreed to use its best efforts immediately to acquire additional Piper shares in order to increase its holdings to more than fifty percent. It promised to make an offer to Piper's public shareholders to exchange their stock for a package of Bangor Punta securities.[14]

On May 8 the parties issued a press release announcing the agreement and that Piper shareholders would be offered a package of Bangor Punta securities which would have a value in the written opinion of First Boston of eighty dollars or more. The registration statement had of course not yet been filed, and the precise composition of the Bangor Punta package was not determined until July 18, the day its registration statement became effective. The Chris-Craft exchange offer had, in the meantime, become effective on May 15.[15]

On May 26 the SEC instituted an action in the United States District Court for the District of Columbia against Bangor Punta and Piper alleging that the announcement of the eighty dollar estimate for an unspecified and unregistered package of securities violated § 5(c) of the Securities Act of 1933 and rule 135 thereunder. Bangor Punta and Piper immediately agreed to a consent injunction against repetition of similar announcements, without admitting the allegations of the complaint.[16]

The May 8 agreement between the Piper family and Bangor Punta

---

[12] 480 F.2d at 351-52.

[13] On March 23, 1969, Piper issued almost 470,000 authorized but unissued shares to acquire U.S. Concrete Company of Florida and Southply, Inc. This increased the number of outstanding Piper shares by about twenty-nine percent and, in the case of one of the corporations posed a potential antitrust problem to Chris-Craft were it to obtain control of Piper. The transactions were quickly rescinded, however, because Piper found itself in violation of the rules of the New York Stock Exchange. 480 F.2d at 352.

[14] *Id.* at 353.

[15] Brief for Appellant Chris-Craft Indus. at 20-21.

[16] 480 F.2d at 353.

provided that if Bangor Punta obtained more than fifty percent of Piper's shares, the consideration to be paid to the Piper family would be increased by the difference between the value of the package of Bangor Punta securities issued to Piper family members and eighty dollars a share. As matters developed, the consequence of the provision was that members of the Piper family stood to receive a premium of approximately thirteen million dollars for their Piper shares if Bangor Punta was able to obtain majority share ownership. During the two months preceding commencement of the Bangor Punta exchange offer, Piper management sent several communications to its shareholders urging acceptance of that offer. None of these letters mentioned the possible premium which the Piper family might receive.[17]

The May 8 press release had not been the first aspect of the battle to attract the attention of the Securities and Exchange Commission. On April 7th, the SEC staff had summoned Piper and Chris-Craft to a meeting and advised that in its view, rule 10b-6 under the Securities Exchange Act of 1934 prohibited a tender offeror from purchasing stock of a target company during an exchange offer. Chris-Craft thereafter refrained from buying Piper stock until after the close of its exchange offer.[18] The SEC staff also warned Piper insiders against purchasing Piper shares. On May 5, the SEC issued a public release proposing rule 10b-13[19] which would explicitly prohibit the purchase of target company stock by a tender offeror during its exchange offer.

First Boston, Bangor Punta and Piper all learned of the SEC press release shortly after its issuance. Nonetheless, large block purchases had already figured in the Bangor Punta strategy, and through purchase of three blocks of stock between May 14 and May 23 Bangor Punta acquired over 120,000 shares, or more than 7½ percent of Piper's outstanding stock.[20]

Additional subjects for litigation were yet to come. Bangor Punta's registration statement in connection with the offer showed the Bangor and Aroostook Railroad [hereinafter referred to as BAR], a subsidiary of Bangor Punta, as having a book value of $18.4 million. This figure

---

[17] Brief for Appellant Chris-Craft Indus. at 23-24. This information did, however, appear in Bangor Punta's preliminary prospectus sent to all shareholders long before the Piper letters of June and July were mailed. In fact, shareholders were advised by Piper's June 4 letter "to read and study the material carefully." Chris-Craft sent a letter to shareholders on July 16, 1969 discussing and criticizing the "bonus" provision and alerting shareholders to consider its consequences. Brief for Appellee, Piper Aircraft Corp. at 24, Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973).

[18] 480 F.2d at 352.

[19] SEC Exchange Act Release No. 8595 (May 5, 1969).

[20] Brief for Appellant Chris-Craft Industires at 24-27.

was based on an appraisal by an investment banking firm made several years earlier. The registration statement did not disclose that serious talks had been initiated earlier that month between Bangor Punta and Amoskeag Corporation for the sale of the railroad for $5 million. The sale of the railroad at that figure was consummated by autumn and produced a book loss to Bangor Punta of $13.8 million. This contributed to a net loss of $1.25 per share for 1969, and wiped out 36.5 percent of Bangor Punta's retained earnings and twelve percent of shareholders' book equity.[21]

As noted, the first Chris-Craft exchange offer had been unsuccessful. Chris-Craft subsequently filed a new registration statement for a more attractive exchange offer, which became effective on July 24 and lasted until August 4.[22] The Bangor Punta exchange offer had been in effect from July 18 until July 29. As a result of the competing exchange offers, Chris-Craft acquired 112,300 shares and Bangor Punta 111,700 shares (about seven percent of the outstanding shares) of Piper. The latter amount, coupled with the seven percent it acquired through the exchange offer, was enough to give Bangor Punta 50.8 percent of the shares of Piper.[23] Bangor Punta announced plans to merge Piper into Bangor Punta soon thereafter.

Even before the battle for control was over, Chris-Craft commenced an action for damages and equitable relief, alleging violations of the securities laws by Bangor Punta and Piper and seeking an injunction restraining both defendants from further interfering with Chris-Craft's purchases of Piper stock. Chris-Craft was completely unsuccessful in its efforts to obtain relief at the district court level. The motion for an injunction was denied as was a later motion by the SEC seeking to enjoin Bangor Punta from further violations of the securities laws.[24] Likewise all claims for damages and equitable remedies were dismissed by the district court, except that an SEC order was granted requiring Bangor Punta to offer rescission to shareholders who accepted the Bangor Punta exchange offer.[25]

II. STANDING: THE ISSUE UNDER SECTION 14(e) AND RULE 10b-5

Chris-Craft pursued on appeal its contention that defendants had vio-

---

21 *Id.* at 31-32.

22 480 F.2d at 354.

23 *Id.* at 354.

24 *Id.* at 355.

25 Chris-Craft Indus. v. Piper Aircraft Corp., 337 F. Supp. 1128 (S.D.N.Y. 1971). *See* discussion in text, note 74 *infra.*

lated § 14(e) of the 1934 Act and rule 10b-5 when they issued improper and misleading press releases, when Bangor Punta filed its exchange offer registration statement with material omissions and when the Piper family sent out letters to Piper shareholders with material omissions and misstatements. Chris-Craft claimed damages for these alleged violations of the anti-fraud provisions of the securities laws as a plaintiff in a unique position—that of a defeated corporate contender for control suing both the target corporation and the successful tender offeror. Never before had a plaintiff in Chris-Craft's position been granted standing either under rule 10b-5 or § 14(e) to sue for damages. This issue had never been raised under § 14(e) and presented obvious difficulties under rule 10b-5. In order to successfully assert standing under rule 10b-5, a plaintiff in Chris-Craft's position (at least in the Second Circuit) had to show that it was a "purchaser" or "seller" of securities in accordance with the rule in *Birnbaum*[26] or show that it fell within an exception to this requirement.

Chris-Craft relied heavily on *Crane Co. v. Westinghouse Air Brake Co.*[27] as affording it standing under rule 10b-5 to assert violations relating to the Piper family press releases and the Bangor Punta registration statement. Crane, like Chris-Craft, was a defeated tender offeror, who had sought to obtain control of Westinghouse Air Brake Company. In an effort to prevent Crane's takeover, Air Brake and Standard devised a merger proposal. In its tender offer, Crane had offered a package of stock and debentures totalling fifty dollars for each Air Brake share. On the final day of the Crane tender offer, Standard purchased 170,000 Air Brake shares on the New York Stock Exchange at an average cost of $49.50, and then immediately sold the 100,000 shares in a private transaction off the Exchange and 20,000 more at a negotiated price for an average price of $44.50, thus taking an apparent loss of $500,000 on the day's trading. Presumably the effect of this trading was to suggest to the owners of Air Brake Securities that their Air Brake shares were worth in excess of fifty dollars, and hence that it would be inadvisable to tender to Crane. Later, at a special meeting of Air Brake shareholders called to approve a merger between Air Brake and Standard, the proxy count ran heavily in favor of the merger.

Crane's thirty-two percent holdings in Air Brake, acquired principally through its tender offer, were subsequently converted into Standard's convertible preferred pursuant to the merger agreement. Thereafter in response to Standard's threat of a divestiture action under the antitrust

---

26 Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952).

27 419 F.2d 787 (2d Cir. 1969), *cert denied*, 399 U.S. 909 (1970).

laws, Crane sold all but 10,000 shares of its holdings in Standard at a profit of several million dollars. The court of appeals found that Air Brake had violated § 9(a)(2) of the Exchange Act[28] and that the violations had placed Crane in the position of a "forced seller" under rule 10b-5:

> Standard acted for the "purpose of inducing" sale by Crane. Standard's actions had the intended effect of inducing Crane to become a seller within the meaning of Section 9(a)(2), for if successful in defeating Crane's tender offer and consummating the merger, antitrust considerations would require sale by Crane of the shares held by Crane or those received in exchange.[29]

The court went on to hold that failure to disclose this trading scheme to the shareholders constituted a violation of rule 10b-5, stating that the reliance requirement was satisfied where the deception misled shareholders and thus, in consequence, caused Crane's injury. The court stated that even under a narrow view of § 9(a)(2), Standard's conduct would still be actionable under part (c) of rule 10b-5, which proscribes conduct "operating as a fraud or deceit upon any person."

Chris-Craft argued that as a defeated contender for control it, like the plaintiff in *Crane*, was a "locked-in buyer" which would be forced to sell its shares in Piper at a substantial loss in the event Bangor Punta chose to effect a merger with Piper. Thus, its position was analogous to the position of the plaintiff in *Crane* as a "forced" seller. However, the district court rejected Chris-Craft's argument that it stood in essentially the same position as Crane, on the grounds that no merger was proposed by Bangor Punta at the time of the litigation, although Bangor Punta had stipulated to the Court that it would *defer* merger plans until the litigation was resolved.

As an alternative to the "forced seller" theory, Chris-Craft asserted standing under the exception to *Birnbaum* discussed in *Iroquois Industries, Inc. v. Syracuse China Corp.*[30] In that case, Iroquois had proposed a tender offer for 50,000 shares of Syracuse China. The management of Syracuse China, Harold C. Brown & Co., Inc. (Brown), and Towle Company conspired to prevent Iroquois from obtaining Syracuse China shares under its tender offer. Syracuse China sent letters to its shareholders

---

28 Securities Exchange Act of 1934, 15 U.S.C. § 78k(a)(2). Section 9(a)(2) proscribes transactions in any security registered on a national securities exchange which have the effect of "creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

29 419 F.2d at 794.

30 417 F.2d 963 (2d Cir. 1969).

falsely stating that it was negotiating a merger with Towle and that details of the merger would soon be released. In fact, no merger was ever contemplated and statements to that effect were simply designed to interfere with the tender offer. Brown refused to advise its customers of the Iroquois tender offer, but instead advised them to sell their shares to members of Syracuse China Management. Iroquois sought an injunction against defendants, alleging that the misleading letters to Syracuse China were in violation of rule 10b-5.[31] Unimpressed, the district court denied the injunction, stating that Iroquois had no standing to assert violations of rule 10b-5.

> The *Birnbaum* rule recognizes the policy of Congress in enacting Section 10(b) and of the Commission in adopting Rule 10b-5, namely, the protection of defrauded purchasers and sellers. It is not the province of the courts to extend Section 10b to apply to transactions not intended to be covered by Congress.[32]

But other language in *Iroquois*[33] implied that had plaintiff alleged that during the tender offer it had been mislead as to any purchases and sales by it of Syracuse China stock, plaintiff would have stated a cause of action under rule 10b-5. Chris-Craft relied on this language in stating its own cause of action under rule 10b-5 alleging that it had been misled as to its purchases of Piper stock by misstatements about Piper's product lines found in Piper's annual report. The district court rejected this argument finding that Chris-Craft had made substantial purchases *after* it had discovered that certain statements in the annual report were misleading, thus throwing substantial doubt on Chris-Craft's reliance on such misstatements.[34]

Notwithstanding its observation that the fraudulent acts involved in the case were literally proscribed by rule 10b-5, the court of appeals concluded that the major contribution of § 14(e) of the 1934 Act is to provide a broader standing to the contestants to sue in a fraudulent securities contest. Hence, the court dealt with the standing under § 14(e) and specifically avoided deciding the issue of standing of Chris-Craft to sue under rule 10b-5.

The Second Circuit's steadfast adherence to the *Birnbaum* rule may have been in part a reflection of the existence of § 14(e) since 1968.

[31] The SEC as *amicus curiae* had invited the court to overrule *Birnbaum* in favor of the defeated tender offeror, asserting that *Birnbaum* had already been seriously weakened by several decisions of the Second Circuit. The court flatly rejected this argument and dismissed the Iroquois complaint. *Id.* at 967.

[32] *Id.* at 969.

[33] *Id.* at 967.

[34] 337 F. Supp. at 1144.

The courts may have dismissed claims arising from violations of the securities laws during tender offers brought under rule 10b-5 in order to avoid further broadening the reach of rule 10b-5, especially since § 14(e) on its face applied more appropriately to violations during tender offers.[35] Chris-Craft argued this contention vigorously in asserting its status as a plaintiff under § 14(e), citing Judge Friendly's language in *Crane*:

> The amendment to the Act adding Section 14(e) effective July 28, 1968, should serve to resolve any doubts about standing in the tender offer cases, even where an offeror is not . . . in the position of a forced seller.[36]

The trial court in *Chris-Craft* had declined to deal with the question of whether § 14(e) afforded standing to one competitor for corporate control against another for violation of the securities laws in a tender offer. The district court impliedly rejected the view that the dicta in *Crane* applied to Chris-Craft's situation and commented that it more appropriately applied to situations such as that in *Electronic Specialty Co. v. International Controls Corp.*[37]

Electronic Specialty, the first case to deal directly with subsections (e) and (f) of § 14 of the Exchange Act—where the parties seeking standing to sue were the corporation and its shareholders, held that the target corporation and its shareholders had standing to sue under § 14(e) for antifraud violations, on the theory that § 14(e) was enacted to protect corporations from "raiders" and to protect shareholders of the target corporation from fraudulent misrepresentations made during tender offers. The court in *Electronic Specialty* viewed § 14(e) as essentially a codification of rule 10b-5: "[i]n effect this applies Rule 10b-5 both to the offeror and to the opposition . . . ."[38] The plaintiffs in *Electronic Specialty* included the target corporation, a non-tendering shareholder and a shareholder who had tendered one hundred shares to the offering corporation. As to this last shareholder, the court of appeals found no standing because a rescission offer had been made by the tender offeror, International Controls. The remaining plaintiffs asserted claims against International Controls for making misleading statements to the media, allegedly for the purpose of driving down the price of target corporation

---

[35] Indeed the court in *Iroquois* had observed that since Congress enacted § 14(e) to prohibit fraud by "any person" in respect of tender offerors, it was an indication that in tender offer contests neither the tender offeror nor the target corporation has standing to sue under § 10b or rule 10b-5. 417 F.2d at 969.

[36] Crane v. Westinghouse Air Brake Co., 419 F.2d 787, 798-99 (2d Cir. 1969).

[37] 409 F.2d 937 (2d Cir. 1969).

[38] *Id.* at 940.

stock so as to make the tender offer for Electronic Specialty more attractive.

On appeal, defendant argued that the target corporation lacked standing to complain of a violation of § 14(d) or § 14(e) since it could suffer no injury from a change in ownership of its stock. It further contended that the target corporation was without standing to complain of a violation of rule 10b-5. It also argued that the conduct of the nontendering shareholder disqualified him as a plaintiff. While not specifically reaching the standing issue, the court reasoned that both the nontendering shareholder and the target corporation had standing under § 14(e) to sue for a permanent injunction. According to the court, although a nontendering shareholder suffers no immediate injury from inadequacy of price in the sense that he retains his stock, such inadequacy

> is likely to have a depressing effect on the market for some time and thus may hurt him if, for one reason or another, he should later find it necessary or desirable to sell. Such depression may also harm the target corporation if it should wish to engage in financing or acquisitions and a still different potential for harm to the corporation will exist where it is claimed that the offeror has evil designs on its treasury or business plans.[39]

While the first decision interpreting § 14(e) was necessarily limited by its facts to the situation where a target corporation and nontendering shareholders sought an injunction to prevent violations of § 14(e), the district court in Chris-Craft interpreted *Electronic Specialty* as outlining the permissible limits of standing under § 14(e)—that the section properly extends standing only to the target corporation and its shareholders. It is clear, however, that the district court skirted the entire issue of standing by rendering findings on the rule 10b-5 claims, while deliberately avoiding any finding of standing under either § 14(e) or rule 10b-5. In making such findings, the district court implicitly accepted the notion that § 14(e) was a codification of the case law developed under rule 10b-5 with the exception of the question of standing.

On appeal to the Second Circuit, Chris-Craft argued that there was no such limitation on standing under § 14(e).[40] After avoiding the issue of whether there is standing for a defeated tender offeror to sue for damages under rule 10b-5, the court found that § 14(e) is the fraud provision which more appropriately provides the basis for Chris-Craft's standing to sue.[41] The court of appeals stated that there were two aspects to the standing question:

---

[39] *Id.* at 946.

[40] Brief for Appellant Chris-Craft Industries at 92.

[41] 480 F.2d at 358.

1. Whether Chris-Craft had an economic interest in holding defendants to a fair standard of conduct in the tender offer situation and additionally, whether Chris-Craft had a real and personal stake in the outcome of the litigation;

2. Whether Chris-Craft had a principal federal right of action under § 14(e) against each of the defendants and more specifically, whether it had a claim for *compensatory relief*.[42]

The court of appeals noted that while § 14(e) is silent on the question of a private remedy, the federal courts have many times implied a damage remedy for litigants whose suits for damages have been based on federal statutes lacking any express authorization.[43] Further, the court found that its previous decisions showed nothing inherently unreasonable about extending standing to all parties in a tender offer situation and further noted that under common law principles, a right of action exists when there is interference with a "prospective advantage."[44] Hence, it would not infer from the silence of § 14(e) that Congress intended to deny a federal remedy for such interference in a tender offer and to extinguish a liability which under established principles of tort law normally attends the doing of a proscribed act. Thus the court concluded that a claim for relief under federal law is stated when a defeated contestant for control has been put in a minority shareholder position because of the wrongdoing of its opponent and the margin of victory is such that the defeated contestant can show it had a reasonable chance of obtaining control of the target company, but lost the opportunity because its opponent gained control through means illegal under federal law.[45] Therefore, at least in the Second Circuit,[46] participants in a tender offer contest are now protected by the prohibi-

---

[42] *Id.* at 359-60.

[43] *Id.* at 356-57. *See* Bivens v. Six Unknown Named Agents, 403 U.S. 388, 402 (1971) (Harlan, J., concurring); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

The court in *Chris-Craft* cited the holding in J. I. Case Co. v. Borak, 377 U.S. 426 (1964) in which the Supreme Court found that § 27 of the Exchange Act granted standing to a private party to sue for damages arising out of a violation of § 14(a) and the proxy rules thereunder and held that "no more effective means of furthering a statute exists than to grant the victim of violation of the statute standing to sue for damages." Thus Chris-Craft had standing to sue for damages under § 14(e) since that section was designed to further fair dissemination of information in tender offers. 480 F.2d at 361.

[44] The court also considered its decision in Butler Aviation International Inc. v. Comprehensive Designs, Inc., 425 F.2d 842 (2d Cir. 1970) in which the target company in a tender offer sought a permanent injunction against the tender offeror. In *Butler Aviation*, the court expressly held that standing existed under § 14(e) at least as to a misstatement in the offeror's annual report.

[45] 480 F.2d at .

[46] *See* Eason v. General Motors Acceptance Corp., CCH FED. SEC. L. REP. ¶ 94,344 (1974); Manor Drug Stores v. Blue Chip Stamps, BNA No. 226 D-1 (9th Cir. 1973).

tions on fraudulent conduct developed under rule 10b-5. A defeated tender offeror no longer need show that it was a "forced seller" to fit within the *Birnbaum* doctrine under rule 10b-5, but can now show standing under § 14(e) in a straightforward manner: assertion that it had a *reasonable chance* for success under the tender offer had it not been for the wrongdoing of the defendant.

The test for establishing standing is directly related to the manner in which the court perceived the damages suffered by Chris-Craft. The damage was not that the defeated contestant had to pay more for the stock of the target company due to the securities law violations of its opponent, but rather that it acquired less stock than it needed for control. This view of the damage issue was foreshadowed in *Crane* where the defeated tender offeror was granted standing to sue the target company as a "forced seller," even though it later sold its minority holdings for a profit of several million dollars. The court of appeals in *Crane* remanded the case, both on the issue of market manipulation and deception on the part of the target company and also

> for a further determination in the District Court of the appropriate remedies. Without limitation, these remedies may include damages, if any, prospective injunctive relief, as well as appropriate retrospective relief, notwithstanding the consummation of the merger. . . . The manipulation may be found to have deprived Crane of success in its tender offer in the free market to which it was entitled, in which case divestiture or separation of Air Brake may be required.[47]

The very fact that Crane was in the position of a defeated tender offeror by virtue of securities law violations regardless of any actual monetary loss resulting from that defeat was enough for the court in *Crane* to suggest a damage remedy to the district court.

Presumably a *successful* tender offeror might also have standing under § 14(e). The standing of a successful tender offeror would necessarily depend upon an injury caused by its increased cost to gain control of the target company. Indeed, Bangor Punta made such an argument in its cross action against Chris-Craft. The district court apparently regarded the claim as frivolous and Bangor Punta as not an "apt" plaintiff to raise such issues. The court of appeals affirmed the district court's dismissal, but only on the ground that Bangor Punta failed to adduce sufficient evidence to prove that Chris-Craft violated the securities laws. Apparently, given the proper sets of facts, the Second Circuit would hold that a successful tender offeror had standing to seek damages against a

---

[47] Crane v. Westinghouse Air Brake Co., 419 F.2d 787, 803-04 (2d Cir. 1970).

defeated tender offeror for the increased cost it bore in gaining control due to violations of the antifraud provisions by the defeated contestant.[48]

The framing of the standing issue in terms of a showing that the offeror had a "reasonable chance" of obtaining control of the target company, and in terms of the significance of the fact that the margin of victory was a small percentage, deserves closer scrutiny. What the court appears to be saying, particularly in light of its formulation of the damage issue, is that if a successful tender offeror acquires through violation of the securities law a block of shares without which it would not have taken control, and if the defeated tender offeror might have competed for the same block of shares, then the defeated tender offeror has standing to assert the harm it suffered, because its opponent gained control through means illegal under federal law. Under the court's formulation, it would be irrelevant whether acquisition of such a block of shares by the defeated tender offeror would have given *it* control. It is enough that the illegally gained block foreclosed it from any *opportunity* for control. This formulation of the standing question is directly related to the court's theory of causation and damage.

III. Disclosure Standards under Section 14(e)

The court of appeals held that because the language of § 14(e) tracks the language of rule 10b-5, a violation of § 14(e) is shown where there is a material misstatement or omission in connection with a tender offer and when such misstatement or omission is sufficiently culpable to justify granting relief in accordance with the developed principles of law under rule 10b-5.[49] Materiality and culpability are the two key concepts in the formulation. Materiality focuses on the importance of the omitted or misstated fact—whether a reasonable man would have relied on the fact in his decision to invest or not. While the requirement of a showing of scienter has served to limit imposition of liability under rule 10b-5 to

---

[48] 480 F.2d at 381.

[49] In the Second Circuit, mere negligence has not been sufficient to permit plaintiffs to recover damages in a private action. *See* SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972), nor has *intent to defraud* been an indispensable element in a private action under rule 10b-5. *See* Shemtab v. Shearson Hamill & Co., 488 F.2d 422 (2d Cir. 1971); Globus, Inc. v. Law Research Service, Inc., 418 F.2d 1276 (2d Cir. 1969).

The standard decided upon by the court of appeals for establishing scienter, taking into account the different degrees of culpability which may arise from different levels of duty to disclose, on the part of a person making a misleading tender offer, or a responsible officer of a corporation making such offer, is whether plaintiff has established that defendant either:

1. Knew the material facts that were misstatted or omitted, or

2. Failed or refused to ascertain such facts when they were available to him or could have been discovered by him with reasonable effort. 480 F.2d at 364.

those whose actions have been sufficiently culpable to justify the remedy sought against them,[50] the court's formulation of scienter, in *Chris-Craft*, at least as it applied to the underwriter in a tender offer, attaches liability to conduct which would not be sufficiently culpable to justify a damage remedy under rule 10b-5.

Also, the court of appeals specifically incorporated the fiduciary duty of management of the target corporation to its shareholders in determining § 14(e) violations, thus making specific under § 14(e) what has been incorporated by implication into rule 10b-5 on an ever-increasing basis. By apparently adopting the "high fiduciary duty" of management of the target corporation to its shareholders for the determination of whether any misstatements or omissions were material and whether, in fact, there had been reliance by the shareholders, the court undertook the development of a body of federal corporate law governing the behavior of the parties in a tender offer. According to the court, those with greater access to information, or having a special relationship to investors making use of the information, often may have an affirmative duty to disclose.[51]

1. Piper Management—Liability

The Court took into consideration the high fiduciary duty of fair dealing and honesty which the Piper family owed its shareholders in finding that the January shareholder letters which described the tender offer as "inadequate" were in violation of § 14(e). Under state corporate law in some jurisdictions management of the target corporation in a tender offer owes a fiduciary duty to the shareholders to "evaluate" the tender offer. Such evaluations are typically protected by the "business judgment" rule should the comments or recommendations prove incorrect. *Chris-Craft* effectively expanded this fiduciary duty beyond merely commenting upon which of two competing tender offers might be more favorable to shareholders to a duty of management to be "meticulous and precise" in their representations to shareholders. The court reasoned that shareholders are likely to rely heavily upon the representations of corporate insiders.[52] Characterizations of Chris-Craft's tender offer as "inade-

---

[50] *Id.* at 363.

[51] *Id.* at 368.

[52] In White v. Abrams, 42 U.S.L.W. 2518 (9th Cir. March 15, 1974), the Ninth Circuit severely criticized the approach taken by the Second Circuit in Chris-Craft on the question of the duty of disclosure under Rule 10b-5:

> We believe it unfortunate that the Second Circuit attempted to limit this duty by requiring some degree of scienter or culpability and holding that mere negligent conduct would not be sufficient for liability. The exact standard that the court would apply, however, is not clear to us. The court's reasoning in defining culpa-

quate" in William Piper's letters to Piper shareholders, while perhaps intended as purely an expression of opinion of future value, was not deemed to be sufficiently "meticulous and precise" to satisfy the high fiduciary duty of Piper management to disclose their reasons for opposing Chris-Craft's offer. Apparently corporate management must fully disclose their analytical process to their shareholders with the concomitant risk that if it omits to disclose a fact to its shareholders which is later found to be "material" to an evaluation of the tender offer by the shareholders, it will be held to have violated § 14(e). This would be true regardless of whether or not management's evaluation of the tender offer would stand under the "business judgment" rule under state corporate law or whether the omitted or misstated fact actually entered into management's *own* evaluation of the tender offer. To the extent that management of a target company comments upon the tender offer, the implication of the court's opinion is to suggest that management should clearly and explicitly separate "price" from "value" of the shares in commenting upon the fairness of the tender offer and further, emphasize whether or not, under current market prices, the shareholders stand to make an immediate economic gain if they accept the tender offer price for their shares. Management can then attempt to explain that the shareholders may gain long-term "value" by retaining their shares.[53]

Management's failure to describe the "put" clause in the Grumman agreement was a far more serious and obvious violation than its failure to adequately discuss the merits of the Chris-Craft offer. This omission was found to have been a possible cause of the shareholders failure to tender, even though announcement of the Grumman agreement did not have its intended effect of driving up the price of Piper shares.

Under state corporate law in most jurisdictions, management has a duty to seek shareholder approval for a merger and to the extent that it

bility was, first, to ask what duty of disclosure the law should impose upon the person being sued, second, to examine factors such as the access to information or special relationships that may impose an "affirmative duty" of disclosure, third, to decide whether the person has knowingly or recklessly failed to discharge these duties. The court then summarized that these three liability factors could be stated as: "whether plaintiff has established that defendent either (1) knew the material facts that were misstated or omitted, or (2) failed or refused to ascertain such facts when they were available to him or *could have been discovered by him with reasonable effort.*" 408 F.2d at 364 (emphasis added). It may well be that the analysis in Chris-Craft accurately reflects what the courts have been doing in deciding what state of mind is sufficient for recovery under rule 10b-5, but we choose not to adopt it. We have difficulty with the court's announced position that mere negligence is not sufficient for liability while in the same case it summarizes with language that sets forth a negligence standard, at least for persons with a special duty. (footnotes omitted).

[53] 480 F.2d at 364.

communicates to its shareholders about the merger, full and accurate disclosure of all material facts must be made under the standards developed under Rule 10b-5 and, in case of a defensive merger as in *Chris-Craft*, under § 14(e). Had Piper management described the "put" clause in the Grumman agreement, management's use of a defensive merger would presumably be protected by the "business judgment" rule under various state corporate laws. The court, at least as to its ruling on the Grumman agreement, did not expand § 14(e) to restrict management's use of various defensive techniques.[54]

Piper management was also found to have violated § 14(e) on the basis of its failure to describe in letters to its shareholders in June and July that the Piper family would profit if Bangor Punta gained control rather than Chris-Craft. Under state corporate law, management has a duty to disclose to its shareholders any material interest which they might have in a transaction, regardless of whether the transaction meets the state's standards of "fairness" to the corporation. Such an interest may affect management's choice of one contender over the other, and thus is a material fact about which the shareholder should be apprised in evaluating management's recommendation. Actually, Piper management may have failed in its fiduciary duty to the corporation under the "fairness" doctrine developed in some states, since by contracting for a thirteen million dollar bonus for its shares, it appropriated a bonus belonging to the corporation. The court of appeals ignored the issue of the propriety of the deal and simply incorporated into § 14(e) the fiduciary duty of management to reveal any interest in a transaction about which it is communicating to its shareholders in the same manner in which this duty has been incorporated under rule 10b-5 in situations involving the purchase and sale of securities.[55]

2. Bangor Punta's Liability

Bangor Punta's liability arose from its misstatements and omissions concerning BAR in its registration statement filed with the SEC. The court held that under standards of materiality and culpability, Bangor Punta was required to disclose to Piper shareholders the circumstances surrounding the negotiations for sale of BAR, as well as the effect of such negotiations.[56]

The court of appeals couched Bangor Punta's liability for material omissions and misstatements in the registration statements in terms of a

---

[54] *Id.* at 365.
[55] *Id.* at 365-66.
[56] *Id.* at 370.

"duty" to Piper shareholders. The court imposed on a tender-offeror the duty to act reasonably in discovering and disclosing material information relating to the offer as of the time of the transaction. Presumably, the facts which a tender offeror must make a reasonable effort to ferret out are those relating to the desirability of the offered shares and not those which might influence the judgment of shareholders of the target corporation for other reasons. In particular, the court did not require Bangor Punta to disclose to Piper shareholders that Piper management stood to reap a bonus if Bangor Punta gained control—a fact which the court determined was "material" to Piper shareholders in letters from Piper management. Duty to disclose and breach of that duty under § 14(e) are necessarily a function of the defendant's relationship to the target corporation's shareholders, as is the determination of what is material and what is not. Because of the difference in relationships to the shareholders of the target corporation, Bangor Punta's duty of disclosure was not held to be co-extensive with the "meticulous and precise" standard to which management of the target corporation was required to conform, since that standard was directly related to the high fiduciary duty which Piper management owed to its shareholders. The lesson to contestants is clear: they must disclose only those facts which relate to the investment value of the exchange package which they are offering.

3. First Boston's Liability

First Boston's liability under § 14(e) was based upon its activities as the underwriter and dealer-manager for Bangor Punta's exchange offer. The court of appeals held First Boston liable as an "aider and abettor" of the issuer in its violations of § 14(e).[57] After having found that the carrying value of BAR in the financials was materially misleading, the court propounded the theory that an underwriter, such as First Boston, aware of a material misstatement or omission in the exchange offer or "reckless" in determining whether such material misstatement or omission existed, can be an aider and abettor in violation of § 14(e). Under such a standard, First Boston was held liable as having been "reckless" in its failure to determine that sale of BAR was imminent and that the valuation of BAR contained in the Bangor Punta exchange offer registration statement was inflated.[58] The court, in effect, found scienter as to First Boston as a matter of law.

Notwithstanding the court's formulation of the applicable standard as one of "recklessness," the court may have actually imposed a duty

[57] *Id.* at 370.
[58] *Id.*

upon the underwriter similar to the "due diligence" standard under §§ 11(a)(5)[59] and 12(2)[60] of the 1933 Act—in other words, assuming that other elements of a violation under § 14(e) are present, *scienter* will be found with respect to the underwriter unless it can show that it made a "reasonable investigation" which would satisfy the standards set out in *Escott v. BarChris Construction Corp.*[61] *BarChris* set out the requirement that an underwriter may not rely merely upon oral questioning of corporate management or corporate counsel in testing the accuracy of the registration statement. Rather, the underwriter must test the accuracy of the statements contained in the registration by examining the underlying documents. Although the underwriter may rely on certified financials, it must test the text of the registration in light of those financials for consistency. Unless the underwriter can show that he has conducted a "reasonable investigation," and thus has been duly diligent, it will be held liable under §§ 11(a)(5) and 12(2) of the 1933 Act, according to the *BarChris* formulation.

In *Chris-Craft*, the court held that First Boston was "reckless" because it failed to determine that the sale of BAR was imminent and thus that the carrying value of BAR was misleading. First Boston did question corporate management about the probability of the sale of BAR, after having been alerted to such possibility in the corporate minutes. The court of appeals held, however, that this oral questioning was not enough. First Boston, according to the court, should have pursued the matter further to the point of questioning management of the potential purchaser. It appears that "recklessness" now encompasses the underwriter's failure to be "duly diligent"—even to the point of testing certified financials. By placing the burden on the underwriter to show that it conducted a "reasonable investigation," of the kind sufficient to satisfy the standards in *BarChris*, the court has lessened the plaintiff's burden in proving scienter. Indeed *Chris-Craft* comes dangerously close to shifting the burden of proof to the defendant on the question of scienter. Plaintiff may now rest after showing that the underwriter failed to ascertain certain facts which were available to him. The underwriter can no longer rely upon a showing that he questioned corporate management or counsel—even as to those facts in certified financials—but rather he must show that he tested all material information by reference to underlying documents or by a further investigation.

---

[59] 15 U.S.C. § 77K(a)(5) (1971).
[60] 15 U.S.C. § 77*l*(2) (1971).
[61] 283 F. Supp. 643 (S.D.N.Y. 1968).

B. *Causation*

The principle of law enunciated by the district court which was most hotly contested on appeal was the formulation of causation under § 14(e). The district court believed that Chris-Craft, in order to show the required causation, had to prove that had it not been for the violation of the securities laws by the defendants, the Piper shareholders would have tendered their shares to Chris-Craft. Chris-Craft offered no such evidence at trial. Using this unusually strict standard of causation, the district court found that Chris-Craft had failed to show that it suffered any harm because of the violations. Had the district court viewed Chris-Craft's damage not as loss of control of Piper, but rather loss of the *opportunity* for control of Piper, it might have viewed the causation issue differently. It was clear that Bangor Punta gained control through its violations, and by virtue of its acquisition of a majority of the shares of Piper it foreclosed any opportunity for Chris-Craft to acquire the company.

The district court emphasized that since Chris-Craft was a highly sophisticated corporate investor, it was not deceived by any of the violations of the defendants. But the court of appeals saw the deception of Chris-Craft as irrelevant to the harmful effect of the violations. The reliance of the Piper shareholders on the deception was the harm complained of and the ultimate cause of Chris-Craft's injury.[62]

The court of appeals noted that a subjective test, taking into account the plaintiff's general expertise, familiarity with the affairs of the corporation and access to information about the corporation is sometimes appropriate in judging the reliance of the plaintiff. Such a standard is inappropriate, however, in a situation, such as a tender offer, where the dealings between plaintiff and defendant are wholly impersonal and where factors that influence investor decisions are not readily apparent. Instead the principle of "constructive reliance" is appropriate in class actions where proof that each individual member of the class relied on the deception would be impossible.[63] The court presumed that, absent the various material misrepresentations discussed above, Piper shareholders might not have tendered their shares to Bangor Punta, and thus Bangor Punta would not have acquired the critical seven percent necessary for its success.

According to the analysis employed by the court, there is a potential distinction between causation resulting in the loss of Chris-Craft's op-

[62] Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341, 373, citing List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), *cert denied*, 382 U.S. 811 (1965).

[63] 480 F.2d at 375.

portunity to compete for control of Piper and the actual causation of an economic loss. The court relied on language in *Affiliated Ute Citizens v. United States*,[64] where the Supreme Court stated that "this obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact."[65]

At least one district court interpreted the language in *Affiliated Ute Citizens* in a similar manner before the decision in *Chris-Craft*. In *Guarantee Insurance Agency Co. v. Mid-Continental Realty Corp.*,[66] plaintiff alleged violations of § 10(b) and rule 10b-5 based on material omissions from a prospectus, which had failed to disclose that defendant Mid-Continental was subject to a special risk of having its tax assessment on property increased. Plaintiff alleged that it purchased convertible debentures and common stock of the defendant in reliance on the prospectus, but failed to allege that the market value of its investment had declined because of the omission in the prospectus. Defendant moved to dismiss the complaint on the grounds that it failed to state a claim because of the failure to allege causation. While the district court agreed that causation was an element of the case, it interpreted the language in *Affiliated Ute Citizens* as holding that causation in fact is established by showing that the undisclosed facts were material. In this context, the courts have adopted what is in essence a "but for" test of causation, *i.e.* but for the misstatement or omission, the reasonable investor would have acted differently.

Professor Bromberg refers to causation in this context as "causation of the transaction" and he draws a distinction between causation of the transaction and causation of the economic loss.[67] The defendant in *Guarantee Insurance Agency Co.* raised the issue that it should not be liable for monetary damages if the drop in market price of plaintiff's securities resulted from a situation totally unrelated to the tax assessment omitted in the prospectus. The court, noting that Bromberg characterizes this issue as "causation of the economic loss," viewed this as a damage issue unrelated to the question of whether "causation" as an element of a cause of action has been successfully stated,[68] but it dismissed the complaint as to damages since an allegation of causation of the economic loss is essential in a cause of action for damages under rule 10b-5.

The Second Circuit used a similar approach to the causation issue in *Chris-Craft*. In order to establish causation, it was not necessary for

---

[64] 406 U.S. 128 (1972).
[65] *Id.* at 154.
[66] 57 F.R.D. 555 (N.D. Ill. 1972).
[67] 2 A. BROMBERG, SECURITIES LAW FRAUD § 8.7(2) at 216 (1973).
[68] 57 F.R.D. at 560.

Chris-Craft to establish that the Piper shareholders would have tendered to it but for the misrepresentations of the defendants, thus directly causing Chris-Craft's loss of control. Rather, Chris-Craft need only show that but for the omissions, the Piper shareholders might not have tendered to Bangor Punta, a fact which is established by the materiality of the misstatement or omission—but for the material misstatements the shareholders may have acted differently *i.e.* not tendered at all or tendered to Chris-Craft. A presumption exists that because of the violation Chris-Craft was denied an opportunity to acquire additional shares. If the Piper shareholders had, in fact, held onto their shares, Chris-Craft would not have suffered its injury—an *opportunity* would still have existed to acquire control of Piper.

The question whether the Piper shareholders would have tendered to Chris-Craft if they had not tendered their shares to Bangor Punta is relevant only to the issue of damages. To the extent that the defendants could have shown, even assuming fairness, that Piper shareholders would not have tendered to Chris-Craft, damages would have been mitigated. This burden, an extremely difficult one, would be on the defendants in order to rebut a reasonable presumption of damages.

IV. Rule 10b-6

Chris-Craft also claimed that it was damaged when Bangor Punta purchased three large blocks of Piper stock in May 1969 in violation of rule 10b-6 under the 1934 Act. Rule 10b-6 prohibits bids for or purchases of a security by or on behalf of the issuer of the securitiy if the security is the subject of a distribution. The prohibition includes bids for or purchases of "any right to purchase any such security." During the pendancy of the Bangor Punta exchange offer, Piper shares represented a right to acquire Bangor Punta securities.

In an earlier decision (when Chris-Craft had appealed the denial of a motion for a preliminary injunction) the court of appeals had held that the block purchases contravened the basic prohibition of rule 10b-6, but left open the question of the applicability of an exemption from the rule or the determination of the proper remedy. The trial court ruled that the exemption was unavailable, but concluded that in the context of an action for damages (as contrasted with a suit for an injunction) the technical violations asserted lacked sufficient substance to merit serious consideration as a basis for money damages.

The trial court based its holding on the complete lack of any evidence that Chris-Craft would have achieved control of Piper if Bangor Punta had not made the block purchases. In addition, the court found that neither Chris-Craft nor any Piper shareholders had been misled by any of the block purchases. Noting what it characterized as the local and unpublicized nature of the purchases, the court concluded that they had occurred outside the conventional flow of the securities markets. Concluding that the purchases met the spirit of the exemption, if not the letter, the trial court found that the purchases were substantial in amount and were effected in such manner that they had no stimulating effect on the market. The approach of the trial court evidences a view that violation of the technical requirements of rule 10b-6 creates a rebuttable presumption as to market effect of the violation.

The court of appeals disagreed. Instead the fact of a technical violation of the rule was presumed to result in the undesirable market effect and in reliance thereon. This presumption, moreover, was held to be impliedly conclusive.[69] Given the holding of the court that standing was not limited to purchasers of manipulated securities, a finding of a violation of rule 10b-6 by a contestant for corporate control leaves only the measurement of damages to be resolved.

As with the acquisition by Bangor Punta of Piper shares pursuant to the exchange offer, damage was held to have occurred because of the denial to Chris-Craft of the opportunity for control of Piper. The unlawful block purchases gave Bangor Punta a seven-percent advantage in its quest for control of Piper. Since Bangor Punta ultimately acquired only about fifty-two percent of the outstanding Piper stock, the block purchases were essential to Bangor Punta's gaining control, and thus denied to Chris-Craft the opportunity for control. Hence, the court held that the attainment by Bangor Punta of a majority position through its unlawful block purchases of Piper stock caused a decline in the value of the Piper stock held by Chris-Craft. Thus, the violation of rule 10b-6 by Bangor Punta resulted in a compensable injury to Chris-Craft.[70]

V. Damages

During the two and one half year period between Chris-Craft's motion for a preliminary injunction in July of 1969 and the completion of a trial on the merits, Bangor Punta operated Piper as a division. The company changed in many material respects from the one which Chris-Craft originally sought; thus, by the time of the trial, Chris-Craft was no longer content with a simple injunction against the voting of the Piper shares illegally acquired by Bangor Punta, even though such an

---

[69] 480 F.2d at 378.
[70] *Id.* at 378-79.

injunction would have given Chris-Craft real voting control of the company. The remedy which Chris-Craft sought unsuccessfully in the district court was compensatory damages for the disastrous effect its locked-in minority position in Piper had on the value of its Piper stock. On appeal, Chris-Craft argued successfully that once it is determined that defendants seized control by violations of the securities laws, Chris-Craft had shown injury by the obvious fact that a forty-three percent locked-in minority position was worth far less than it would have been if Chris-Craft had acquired the illegally controlled block. The only issue remaining for the court of appeals was to compute damages by calculating the difference in value between a control block and a forty-three percent unmarketable block of Piper shares. Chris-Craft further argued that defendants could not escape imposition of a remedy simply because such computation would be extremely difficult since the court was under a duty to fashion an effective remedy.[71]

The court of appeals found that damages were an appropriate remedy to compensate Chris-Craft for its financial loss and attempted to provide guidance to the district court as to the sort of relief it should grant at the very least. The court noted that divestiture of the illegally-acquired shares would be too difficult to administer and might reopen the battle for control. The measure of damages decided upon by the court was the one suggested by Chris-Craft: the reduction in the appraisal value of Chris-Craft's Piper holdings attributable to Bangor Punta's taking a majority position, and thus being able to compel merger at anytime. The court further decided that damages should be assessed against all defendants jointly and severally, although no specific finding had been made that Piper management had contributed to the material omissions or misstatements in Bangor Punta's registration.[72]

The court also granted Chris-Craft's prayer on appeal for equitable relief, which it had abandoned at trial, resulting in a devastating injunction barring Bangor Punta, for a period of at least five years, from voting the Piper shares which it obtained through the purchases in violation of rule 10b-6 and through its exchange offer.[73] This prohibition would not apply to those Piper shares retransferred to former Piper shareholders upon acceptance of the rescission offer ordered by the district court. The effect of the court of appeals ruling would be to enable Chris-Craft to assume a management position in the company (assuming the majority of the shareholders to whom Bangor Punta makes it res-

---

71 Brief for Appellee Piper Aircraft Corp. at 100.

72 480 F.2d at 380.

73 *Id.*

cission offer do not accept it). Bangor Punta Corporation and its officers therefore found themselves in the position of paying potentially huge sums in damages for a benefit which they could not enjoy for five years.

VI. Injunctive Relief

An additional problem considered by the court of appeals involved the criteria to be used in granting injunctive relief. The Securities and Exchange Commission had filed a complaint against Bangor Punta Corp. on September 9, 1970, to enjoin Bangor Punta from further violations of the securities laws and to obtain an order offering rescission to all shareholders of Piper Aircraft Corporation who had exchanged their shares of Piper common stock for Bangor Punta securities.

In its opinion filed on August 25, 1971,[74] the district court found that sufficiently serious consideration of the possibility of a sale of the BAR had been given so that the directors of Bangor Punta could not have believed that the $18.4 million appraisal figure represented the true market value of the railroad. It also found that the omission of facts which rendered the appraisal obsolete was material considering the magnitude of the loss which appeared likely. The district court did not find, however, that Bangor Punta, prior to August 27, 1969, had decided to sell the railroad to Amoskeag and hence concluded that Bangor Punta had not deferred the closing in order to avoid disclosure in the pending registration. Nonetheless, because of the material misstatement of the figure at which BAR was carried, the district court ordered Bangor Punta to make a rescission offer.

The SEC appealed the judgment of the district court on two separate issues:

1. The Commission argued that the district court applied an erroneous standard in denying its request for an injunction and, in any event, argued that the district court abused its discretion in not granting the injunction; and

2. The Commission argued that the district court erred in requiring the former Piper shareholders to pay Bangor Punta, as a prerequisite to rescission, any profits realized by them for the sale of the Bangor Punta securities originally obtained by them in the exchange offer.

In objecting to the standard for injunction applied by the district court, the Commission argued that such a standard imposed an additional requirement never before required in an injunction case—that of showing "bad faith" or "evil motive." The Second Circuit had on a previous occasion held that the standard to be applied was whether there

---

74 SEC v. Bangor Punta Corp., 331 F. Supp. 1154 (S.D.N.Y. 1971).

was a reasonable likelihood that the wrong will be repeated.[75] Such reasonable likelihood, the Commission argued, had been already demonstrated in light of the defendant's past violations.[76]

The Commission urged that the standards of public interest (not the requirements of private litigation) should measure the propriety of injunctive relief in cases where the Commission seeks relief, and that the court should be more liberal in granting injunctions, once it has found an unquestioned violation of the law by the defendant, particularly in light of the difficulty of the Government's inspecting, investigating and litigating every complaint of a violation.[77]

Additionally, the Commission argued that the district court erred in requiring former Piper shareholders to pay to Bangor Punta, as a prerequisite for rescission, any profits realized from sale of the Bangor Punta securities originally obtained in the exchange offer. The Commission pointed out that the court by its order had placed Bangor Punta in a preferred position. Under the order, Bangor Punta would obtain the benefit of "profits" obtained by rescinding shareholders who might purchase substitute securities at a price exceeding the proceeds from their sale of original securities.

Although the court of appeals removed the restrictions placed on the rescission order by the district court, it upheld the "natural inclination or prospensity to violate" standard applied by the district court in refusing the injunction, over a strong dissent by Judge Timbers. Judge Mansfield and Judge Gurfein affirmed the district court's decision in this regard on the ground that the district court's finding was not "clearly erroneous," thus withholding their imprimatur on the standard chosen by the district court. Further, the majority of the court held that the difference between the standards "propensity or natural inclination" and

---

[75] SEC v. Culpepper, 270 F.2d 241, 250 (1959).

[76] Brief for Appellants SEC at 30.

[77] The Commission argued further that, even assuming that the district court chose the correct standard for granting relief, it abused its discretion in denying such relief when Bangor Punta had filed a misleading registration statement and prospectus where:

(a) The company was under a court injunction to file documents complying with the registration provisions of the federal securities laws;

(b) The misleading omissions were of facts well known to the company's directors and management; and

(c) The factual omissions were of undoubted materiality to the company's exchange offer, which formed a crucial part of its contest for control of Piper.

Since the nondisclosure was "not merely negligent" but something more, the Commission argued that on that ground alone the injunction should have been granted. The Commission further argued that since Bangor Punta failed to disclose highly material facts within its knowledge, it must be deemed likely to repeat its violation. *Id.*

"reasonable likelihood that the wrong will be repeated" is possibly merely semantic, and in any event not sufficiently different to merit reversal.[78]

Judge Timbers saw a meaningful distinction between the two standards and therefore dissented as to the refusal to grant injunctive relief. In his opinion, the standard "propensity or natural inclination" requires a showing of intent, which is tantamount to converting a proceeding for a civil injunction into a criminal one. Further, Judge Timbers urged that all doubts about granting an injunction sought to protect the public interest should be resolved in favor of granting the injunction. Judge Timbers found that Bangor Punta's conduct was so flagrant a violation of the antifraud sections in the face of a consent order that it could not be heard to claim that its conduct was not clearly unlawful. Because Bangor Punta was a diversified conglomerate, there was a reasonable likelihood, in his view, that it would become involved in similar tender offers in the future, which increased the likelihood of similar violations.[79]

Chris-Craft has not clarified to any great degree the standard for granting a permanent injunction in the Second Circuit. Since the precedential value of the case was greatly weakened by two judges affirming solely because the trial court was not clearly erroneous, it does bode ill for the Commission in its efforts to seek such injunctions. In view of the circumstances of this case showing a pattern of rather flagrant violations by Bangor Punta, the refusal of the court of appeals to reverse the district court either as to the standard for granting the injunction or as to its findings under such a standard sets a dangerous precedent for SEC enforcement efforts. If under facts so favorable for the granting of an injunction, the court cannot be persuaded to grant one, then the SEC has had a powerful weapon in its arsenal of enforcement techniques rendered ineffective.

VII. CONCLUSION

Chris-Craft v. Piper Aircraft Corp. has clarified in many respects the standards of corporate behavior expected of all the participants in a tender offer. The actions of management of the target corporation in opposing an offer are to be tempered by the high fiduciary duty owed to its shareholders; the contestants themselves are to be governed by antifraud standards nearly identical to those under rule 10b-5. The decision has served to confuse the responsibilities of the underwriter in a tender offer and, at least until *Chris-Craft* is clarified by subsequent decisions in this area, the underwriter must conduct a thorough "due dili-

[78] Chris-Craft Indus. v. Piper Aircraft, 480 F.2d at 405.

[79] *Id.* at 388.

gence" investigation of the issuer to avoid the enormous liability which may befall it under § 14(e), should it be held to have been culpable under the very nebulous "recklessness" standard.

With a greater degree of certainty, the court established one definite taboo in a tender offer: the purchase of shares by a contestant during the pendancy of an exchange offer is outlawed. Unless this standard is modified by later decisions, such a purchase will trigger certain liability with only the damages remaining to be calculated.

The Second Circuit will undoubtedly further refine its standards for the granting of permanent injunctions against securities law violators. Until then, the corporate defendant in a suit for an injunction can take heart that the *Chris-Craft* decision is a precedent, albeit a weak one, which weighs heavily in the defendant's favor.